The Romanian - Hungarian border, link or delimitation for the post-adhesion process of Romania and Hungary?

Soproni, Luminita; Horga, Ioan

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Luminița SOPRONI, Ioan HORGA

Abstract: *Today, Romania and Hungary are two countries sharing the same wish: to become active and responsible members of the new great European family. Even if the start was slightly differentiated – Hungary acceded to the EU in 2004 and Romania in 2007 – the post-adhesion evolutions of the two countries are demonstrating the same effort towards the complete integration in the European Union, through the adhesion to the Euro Zone. This paper intends to reveal if the border between the two states plays the role of either connection or demarcation between the economic evolutions of these two member-states of the European Union. On this matter, we will analyze the economic conjuncture, the evolution of the economic indexes and the condition of the different fields of the neighboring economies.*

Keywords*: border, crisis, European Union, member states, economic conjuncture*

After a prolonged economical growth, in 2007 and especially in 2008, the economy of the countries in the Central and Eastern Europe has begun to display a medium rate of growth, due to the lower external demand – as a result of the demand decrease in Western Europe – due to stricter conditions of external financing and, more importantly, due to the outcome of the international financial crisis. The prolonged economic crisis has powerfully stricken the economy of this country in 2009, leading to economic recession and the collapse of several indicators. Central and Eastern Europe's GDP has dropped by 5,0% in 2009 and IMF predicts a 1,8% growth in 2010. The investors are more careful with their involvement in the region, and pay more attention to the conditions of the internal market and the efficiency of public politics. Some countries have large debts in hard currency, which can be extremely pricey if the exchange rate alters. According to IMF experts, in 2010, „recovery in the emerging Europe is likely to be difficult, especially for economies most affected by sharply falling capital flows and domestic financial sector turmoil" (IMF, *World Economic Outlook*, October 2009:67).

The economic situation

After years of sustained growth, **Romania** deals with a significant economic moderation due to the decline of the exports, the reduction of activity in the construction area and the shrinkage of the financing level. According the European Commission, „the economic boom between 2004 and 2008 has led to overheating pressures and unsustainable fiscal and external imbalances: real GDP growth in this period averaged 6.6%; inflation peaked at 8.4% in Q2-2008; the current account deficit reached 12.3% of GDP in 2009; banks and other businesses were increasingly reliant on short-term external funding; half of domestic private credit was in foreign currency. […] The years of pro cyclical budgetary policy had led to a sizeable deterioration in the underlying fiscal position, with the structural deficit rising from 2.4% of GDP in 2005 to 8.5% of GDP in 2008." (European Commission, *Economic Forecast*, Autumn 2009:138).

After adhering to the EU in January 2007, Romania has entered a new phase of **economic growth,** with major foreign investments. The growth rate of the GDP (Gross Domestic Product) was 8.4% in 2004 and decreased substantially in 2005, to 4.1% (IMF, *World Economic Outlook*, April 2008:246) as a result of the flood and imports increase. Nevertheless, beginning with 2006, the country has seen spectacular evolutions in the growth rates: 8.6% in 2006 and 6.0% in 2007. Romania's GDP increased by 6% in 2007 as a result of the expansion of such economic areas as the constructions and services, which were able to compensate for the major decline of the agricultural sector (-1.3%). The factors that have led to the decrease in the agricultural product were: the drought, the low productivity rates, the reduction of the cultivated areas and the surfaces left uncultivated (more than one million hectares). The constructions field represents one of the most dynamic economy branches: in 2007 it has increased with 37.5%, the highest level in Europe. Services have also increased, representing more than 50% of GDP; the industry has the same value in the last years, which is about 27-28% of GDP.

In its 2008 autumn economical forecast, the European Commission considered that Romania's economy was „overheated", and the growth would slow down. Even though during the first half of 2008 the economic growth has speeded up to 8.8%, during the second half of 2008, a reduction of the internal demand was expected (as a result of the international financial crisis). (European Commission, *Economic Forecast. Autumn 2008*:106-107). The International Monetary Fund also forecasted a major reduction of Romania's economic growth for the following years, with a value of 4.8% in 2009, as a consequence of the decrease in the economic growth supported by expenditure, a consequence of the restricting monetary policy for credits and of the international financial situation that would have a negative influence on investments. The IMF representative for Romania considered that there was a „large amount of incertitude about this prospect because it is difficult to evaluate the effects that the present turbulence will have" (Mediafax News Agency, 23 September 2008).

But all these predictions have been dramatically changed by the major event that started in the final part of 2008: the world economic crisis. Romania's GDP growth was substantially reduced by the final trimester of the year, marked by the first effects of the international crisis that could be felt. Despite the optimistic estimations made at the beginning of last year, economic growth was just 7.1%, only 1.1% more than in 2007. Therefore, in 2008 the final total consumption grew by 8% as compared to 2007, the expenses for the population's final household consumption went down by 4.7% in the final trimester, due to the reduction of the amount of retail trade (-1.8%) and of services offered to the population (-14.7%). The industry's ratio in the total of the GDP has come to be lower than that of commerce in 2008, recording a rebound of four percentages compared to 2002. It is most likely that the assessment of the Romanian currency, which stimulated credits in foreign currency and the purchase of estate, was the factor that determined a series of economic agents to reorient from the industrial area towards the construction domain. This explains why, along with the reduction of industry's ratio to the GDP, there was a growth of the construction's ratio in 2008 compared to 2002. During this time, the agriculture's ratio in GDP has shrunk; decline which was compensated by the growth of services (seen as a whole, including trade) and net product tax (*Săptămâna Financiară online*, March 22, 2009).

According to the Romanian economist Liviu Voinea, the analysis of the internal economic crisis in Romania outlines the vulnerability of Romania's economic growth after 2001, dependent on private short term external loans and sustained by the internal consumption based on external financing, the real estate boom and the pro cyclic fiscal and budgetary politics (single tax quota, the increase of the budget salaries). Voinea therefore calls the Romanian economy an "economy of illusion" (the illusion of the personal common wealth), based on the speculative inflows of foreign capital that have financed the imports. He also emphasises the role the anti cyclic politics had in 2006-2008, at the outset of the crisis. The large budgetary deficit leads to the understanding of Romania's difficulty in adopting anti cyclic politics in order to reduce the effects of the crisis, as well as the countries in the Euro Area or in the USA. The lack of a strategic vision and the postponing of the deeply needed structural reforms have led to chaotic economic development, based on consumption and debt rather than investments. Voinea considers that the economic crisis in Romania is an internal one, which would have appeared in the absence of the global economic crisis just as well. The Romanian crisis is in fact a typical crisis of financing of the current account deficit (Voinea, 2009:63-78).

Table 1. Romania. Contributions in the GDP increase (sectors)

%	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
GDP	**4.2**	**7.9**	**6.0**	**7.1**	**-7.7**	**0.5**	**2.4**	**3.7**	**4.4**	**5.2**
Industry	0.6	1.7	1.2	0.3	-1.7	-0.3	0.2	0.7	0.9	1.0
Agriculture	-2.2	0.3	-1.3	1.2	-0.5	0.1	0.2	0.2	0.3	0.2
Constructions	0.6	1.6	2.5	2.3	-2.1	0.3	0.6	0.7	0.8	0.8
Services	4.2	3.4	3.5	2.6	-2.4	0.3	1.2	1.7	1.9	2.8
Net taxes on product	1.0	0.8	0.2	0.7	-1.2	0.0	0.2	0.4	0.4	0.5

Source: The National Forecast Commission, the *Autumn forecast 2008*, October 20th, 2008
The National Forecast Commission, the *Autumn forecast 2009,* November 5th, 2009

The European Commission considers that, in 2009, Romania's economy would shrink by 8%, followed by a slight growth in 2010, for which period of time they estimate, just like the National Prognosis Commission, a growth of 0.5% (European Commission, *Economic Forecast,* Autumn 2009:140). The European Bank for Reconstruction and Development (EBRD) also estimates a contraction of Romania's economy by 8% in 2009 and a growth of 1% in 2010 (EBRD, *Transition Report 2009*). The estimation of Fitch's rating agency for 2009 – a 7.5% contraction – is slightly more optimistic than those of EC, EBRD and the National Prognosis Commission, which believe that Romanian economy's contraction would be 7.7% in 2009, and than that of IMF which considers GDP's reduction to reach 8-8.5%. As for 2010, Fitch predicts a return of growth, with a rate of 2%, this time far larger than the 0.5% predicted by Romania's National Prognosis Commission[1].

In the second half of 2009, the first signs of economic recovery started to appear, initially driven by export demand. The decline in industrial production and exports has been moderate and the private credit developments

[1] „Estimare optimistă de la BERD: Economia României va crește cu 1% în 2010"; in *Wall Street*, 16 October 2009, http://www.wall-street.ro/articol/Economie/73421/Estimare-optimista-de-la-BERD-Economia-Romaniei-va-creste-cu-1-in-2010.html; „Fitch: Economia României va creste cu 2% in 2010", in *Wall Street*, 30 October 2009, http://www.wall-street.ro/articol/Economie/74274/Fitch-Economia-Romaniei-va-creste-cu-2-in-2010.html

turned positive. The recovery of domestic demand is expected to follow with some delay, given the still rising unemployment-rate and the decelerating wage growth. Real GDP growth is expected to turn positive by the first quarter of 2010 (European Commission, *Economic Forecast*, Autumn 2009).

Table 2. Romania. Contributions in the GDP increase

%	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GDP	**4.2**	**7.9**	**6.0**	**7.1**	**-7.7**	**0.5**	**2.4**	**3.7**	**4.4**	**5.2**
Internal demand	**8.6**	**14.0**	**14.8**	**9.0**	**-14.4**	**0.9**	**3.0**	**4.7**	**5.4**	**6.1**
Final consumption	8.2	8.1	8.5	6.6	-8.8	1.0	1.3	2.6	2.8	3.4
Gross fixed capital formation	0.4	5.9	6.2	2.4	-5.6	0.0	1.7	2.1	2.6	2.8
Net exportation	**-4.4**	**-6.2**	**-8.7**	**-1.9**	**6.7**	**-0.5**	**-0.6**	**-1.0**	**-1.0**	**-0.9**

Source: The National Forecast Commission, the *Autumn forecast 2008,* October 20th, 2008
The National Forecast Commission, the *Autumn forecast 2009,* November 5th, 2009

Over the last few years, **Hungary** has been facing a much more difficult situation than Romania. The country had lower GDP growth compared to most neighboring countries and even old Member States in both 2007 and 2008 (European Commission, *Economic Forecast*, Autumn 2009:120).

After it benefited from an economic revival in 2004, subsequent to its adhering to the European Union, Hungary recorded a decrease in the growth of the GDP as compared to the rest of Europe: from 4.8% in 2004 to 4.1% in 2005 and 3.9% in 2006 (IMF, *World Economic Outlook*, April 2008:246). In 2005, the economic growth had a lower value as compared to that of the other economies which had joined the European Union in 2004. The difference was even greater in 2006, when the GDP growth decreased to 3.9%, in a period of time when many of the European countries have had an accelerated growth pace. According to Askoka Mody, Executive of the European Department of the IMF, indicators of in depth issues have been visible before the consolidation was initiated. By mid 2006, before the fiscal consolidation was made public, investments decreased substantially. Mody says that that was rather unexpected and represented a warning regarding the fact that investors were becoming increasingly cautious as far as Hungary's future was concerned (*The Budapest Sun*, 24 October 2007). Private consumption has also started to decrease before the fiscal consolidation policies were announced, and the latter included more lax employment provisions and leveling real net incomes. Within this context IMF specialists have also forecasted a decrease in Hungary's relative profitability. Gross national investments decreased to 23% of GDP in 2006, while foreign direct investments increased to 2.7% of GDP (IMF, *Hungary. Staff Report for the 2007 Article IV Consultation*, 2007:7-8). Beginning with the last months of 2006, the growth rate of the GDP (around 3%) dropped down under the rate manifested in the Euro Zone. According to IMF experts, the forecasts for the following years announce a slight resilience of the economic growth: 1.8% in 2008 and 2.5% in 2009 (IMF, *World Economic Outlook*, April 2008:246). The high rate of unemployment contributes to maintaining a low growth rate in consumption. Recent developments of the investments are not favorable either, and the virtual standstill in corporate borrowing contributes to keeping investments at a low level (IMF, *Hungary. Staff Report...*, 2007:14). Economic growth was reduced to 1.1% in 2007 as compared to the historical average of 2001-2006. The severe financial measures adopted at the middle of 2006 have had a significant role in slowing down the pace. The private sector has had a slight improvement, consumption costs increased by 0.7% in 2007, despite the 5% decrease of the real salary. For the year of 2007, the agricultural sector, dominant in former days, represented only 4.2 % of the GDP, equal to the construction sector. The industry amounted to a percentage of 25.2% of the GDP, and services contributed with 66.4% (*CEE Economic Data – Outlook for 2009-2010*, Issue 2, 2008:14).

This moderately positive evolution continued in the first half of 2008 but was annihilated by the international financial crisis. Hungary was in a fragile economic condition when the financial crisis broke out in the autumn of 2008. Hungarian financial markets were strongly affected starting with October 2008. The country faced the freeze of the government bonds market, the fall of the stock market and the severe depreciation of the forint. These events were brought about by Hungary's weaknesses, for instance the highly significant external debt. Consequently, the European Commission foresaw a 1.7% increase for 2008 and only a 0.7% increase for 2009 (European Commission, *Economic Forecast. Autumn 2008*:92-93). The Prime Minister of Hungary feels that the recession which Hungary has entered is long term (18 months) and the difficult part is yet to come. Hungary's economy will slow down even more in 2009, as export drops and the national consumption is connected to budget limitations and salary drops. Therefore, the Hungarian government has launched a plan of economical stimulants in order to save the country from recession, but the strict budget control doesn't allow new expenses and the central bank has sent the warning that the economical regeneration will be slow (*Budapest Business Journal online*, November 2008).

In November 2008, acknowledging the government's commitment to maintain the fiscal consolidation process and to prevent a more severe financial market crash, a joint financial assistance of up to EUR 20 billion was provided to Hungary by the EU, the IMF and the World Bank linked to policy conditions. In order to counteract the decreasing revenues caused by declining output, the government also implemented a mix of structural and temporary expenditure saving measures. However, the European Commission foresees a reduction of GDP by 6.5% in 2009, followed by another reduction in 2010, only this time much smaller: -0.5% and a growth of 3% in 2011 (European Commission, Economic Forecast. Autumn 2009:120-122). The European Bank for Reconstruction and Development (EBRD) also estimates a contraction of Hungary's economy by 6.5% in 2009 (EBRD, *Transition Report 2009*). According to IMF experts, „real GDP is projected to fall by 6.7 percent in 2009 and 0.9 percent in 2010. In 2009, domestic demand and imports are now projected to be slightly weaker, reflecting the outcome in the first half of 2009. In 2010, net exports are broadly unchanged, as the improvement in the global outlook is offset by a more appreciated exchange rate" (IMF, *Hungary: Country Report No. 09/304*, 19 October 2009).

Based on diminishing real wages and increased uncertainty regarding employment, consumption expenditure by households is foreseen to decline by more than 10% between 2008 and 2010. At the same time, fixed capital formation is also expected to decrease substantially due to financing difficulties and low capacity utilisation, with the possible exception of infrastructure investments linked to EU funds. Net exports are projected to make a large positive contribution to growth as imports fall even faster than exports (European Commission, Economic Forecast. Autumn 2009:120).

Aspects of the monetary policy

Monetary policy in Central and Eastern Europe countries loosened up noticeably toward the end of 2008 and the beginning of 2009 in the face of sharply slowing economies and easing inflation. Policymakers started to rethink monetary easing given the dramatic currency declines across the region at the beginning of 2009. Romania and Hungary have flexible exchange rates and independent monetary policy.

Starting with 2000, disinflation in **Romania** has been continuous, the phenomenon being confirmed by the annual inflation average rate, which dropped every year from 45.7% in 2000 to 6.6% in 2006 and 4.8% in 2007 (IMF, *World Economic Outlook*, April 2008:252). In 2005, the strategy of direct inflation targeting had a special role in this process; consequently, the prognoses of the inflation level had low values. The anticipations for 2008 are not very optimistic and the National Commission of Prognosis has estimated a level of 8% for the average inflation (Mediafax News Agency). In the report on inflation published at the beginning of February 2008, the National Bank of Romania (NBR) revised by 1.6 per cent the increase for the inflation forecast in 2008, from 4.3% to 5.9%, while the estimated value of inflation for December 2009 is 3.9% (NBR, *Inflation Report*, February 2008). The data given to publicity by the European Office of Statistics, Eurostat, confirms the previsions, showing that the annual inflation in Romania has been 7.3% in January 2008 as compared to the same month of the last year (placing our country on the seventh place in the European Union) and 8% in February, when Romania went two places up in the European top of inflation rate, reaching place five, left behind only by the Baltic countries and Bulgaria (EUROSTAT, February 2008).

On the 26th of March 2008 the increase of the inflation has determined the Central Bank to increase the monetary policy rate from 9% to 9.5% (NBR Press release, March 2008). Thus they are trying to decrease the consumption and the possibility of opening new credits which increase the inflation. This is the fourth consecutive increase of the monetary policy rate performed by the Central Bank; on 31st October 2007 the key interest rate was 7%. The National Bank of Romania explains that the analyses performed confirm the possibility to achieve an annual inflation rate above the highest limit of the variation band due to the continuous and excessive domestic demand and also to the lasting effects of the shocks caused by the nature of the offer (mainly the international prices for food and fuels). In the Convergence Programme 2006-2009, elaborated by the Romanian Government, they consider that „the monetary policy rate together with the policy of market liquidity control and the additional measures aimed at slowing down the pace of non-government credit growth are expected to be the main pillars of controlling the aggregate demand" (Government of Romania, *Convergence Programme 2006-2009*, 2007:9).

On July 31, 2008, the Administration Council of the NBR decided to increase the monetary policy rate to 10.25% per year. The context created by the internal macroeconomic evolutions and the uncertain climate of the international markets rendered NBR to decide, in its session of October 30, 2008 to the monetary policy rate at 10.25% per year. The decision had the aim to provide a balance between the gradual growth of monetary restrictions – as a result of increased inflation, in order to achieve medium term disinflation targets, and the required caution due to the emergence of new sources of risk on the macroeconomic side (NBR Press releases, 2008). As a consequence of the ongoing turbulence on the financial markets and of the slowing down of the overall activity, a slowing of the economic growth and an increase of the inflation rate were expected towards the end of 2008 and 2009. That is why NBR has once again revised the inflation rate for 2008 from 6.6% to 6.7%, with these figures being much over the ones from the beginning of the year. This evolution has been generated by the pressure exerted by the growth of labor unit cost, the increase of the external prices of industrial products and by the demand excess subsequent to the population income increase and of the credits given to the private sector. The forecasts for 2009 have also been modified from 4.2% to 4.5% (NBR, *Inflation Report*, November 2008). The NBR Governor motivated the decision by the major uncertainties on the market during the period analyzed.

In 2009, a year strongly marked by the effects of the crisis, Romania's Council of Administration of the National Bank has decided to reduce the interest rate of monetary politics to 9.5% per year, starting with May 7, 2009, in order to invigorate the credit process of the Romanian economy. The process started by BNR continues with the following steps: reduction of interest rate of monetary politics to 9% per year starting with 2009, as disinflation continues, the inflation annual rate descends to 5.95% in May 2009, due to a tempered dynamic of administrated and essential prices. This decision is desired to contribute to the insurance of an adequate level of cash flow and to the gradual come back to the interest rates practiced by commercial banks to their natural functional position reported to the interest rate of monetary politics; the reduction of interest rate by monetary politics to 8.5% per year starting with 5^{th} of August 2009 as a consequence of the strengthening of the disinflation process through the reduction of prices dynamics of fuel and aliments as the set reductions of request and the temper of the sensitivity of the leu's exchange rate. Although the process of disinflation continues, its track is marked by the continuing evolution of the economic crisis worldwide and the maintaining of significant structural rigidity in Romanian economy; the reduction of interest rate of monetary politics to 8% per year starting with September 30, 2009 in a context marked by the reduction of the annual inflation rate to 4.96% in August, the significant and persistent adjustment of external deficit as the effects of economic and financial crisis can be seen worldwide, the persistency of high annual dynamic of credits given for the public sector, the recording of a positive monthly dynamics of the credits given to the private sector for the first time in the past six months and the continuation of the growth tendency for savings at the level of national economy. In the session of November 3, 2009, Romania's National Bank's Administration Council set as an inflation target for 2009 a level of 3%, with a variation interval of ±1%, lower than 3.5% in 2010 (NBR Press releases, 2009).

As far as the inflation rate is concerned, at the beginning of 2000, **Hungary** was far better off than Romania, having a 9.8% inflation rate, as compared to Romania's rate of 45.7%. The rate of inflation in Hungary gradually decreased in 2000-2003, reaching 4.6% in 2003. The year when Hungary joined the European Union (2004) the value of inflation was higher (6.8%) but decreased afterwards to 3.6% in 2005 and 3.9% in 2006. Nevertheless, in 2007 the inflation pressure determined the inflation to reach 7.9%. The IMF forecast for the following years is 5.5% for 2008 and 3.4% for 2009 (IMF, *World Economic Outlook*, October 2008). In august 2008 the inflation rate reached 6.5 %, high above the target value of 3% set by the Central Bank. This increase determined the National Bank of Hungary (Magyar Nemzeti Bank) to modify the inflation target to 6.3% in 2008 and 4,1% in 2009 (Magyar Nemzeti Bank, *Quarterly Report on Inflation,* august 2008:10).

According to officials from the National Bank of Hungary, „rapid disinflation continued at the end of 2008". The average annual inflation rate was 6.1% in 2008. The sharp drop in international commodity prices was the main contributing factor to the fall in inflation; however, declining domestic demand also had a perceptible effect on prices: despite the substantially weaker exchange rate, tradables inflation declined and the rate of increase of services prices fell further." (Magyar Nemzeti Bank, *Quarterly Report of Inflation*, February 2009: 7, 18). The descending trend continues in 2009, as „subdued domestic demand has accelerated the nominal adjustment of the economy. The price-reducing effect associated with the general trend of shrinking sales opportunities is increasingly strong. Accordingly, following the indirect tax raises, the ensuing increases in price levels were weaker than expected, and a strong disinflationary trend was observed even amongst market services, which have a history of persistently rising price levels. Increasingly subdued pricing decisions have been accompanied by deceleration in nominal wages as well. This process is also expected to remain characteristic in the coming years, contributing to the development of a sustained, low inflation path" (Magyar Nemzeti Bank, *Quarterly Report of Inflation*, November 2009:3).

The monetary policy rate set by the National Bank of Hungary has had the same value of 8,5% since May 27, 2008, second in EU only to Romania's rate. The Monetary Council of the Central Bank decided in its extraordinary session held on October 22, 2008 to increase to monetary policy rate to 11,5% (Magyar Nemzeti Bank, *Press release,* October 2008), after the forint's significant depreciation to the euro. The decision is made in a time when Hungary is trying to consolidate its financial markets and to annihilate the impact of the global financial crisis, against a background of decreased economic growth and increased budget deficit, which lead investors to sell the assets they owned on the Hungarian market. Some analysts think that the decision of the Hungarian authorities was one of the last means Hungary has for supporting the national currency (Capitalul.ro, 23 October 2008).

Just like in Romania, the officials of the National Bank of Hungary have come to accomplish five successive reductions of the interest rate of monetary politics during 2009, starting with the month of July. In November, the Central Bank has reduced the interest rate of monetary politics to 6.5% (Magyar Nemzeti Bank, Press releases, 2009). The National Bank of Hungary's monetary policy council has decided to remain cautious on interest rates mainly due to external risks. The key interest rate in Hungary is one of the highest in the European Union, but not as high as in Romania, where it is of 8%.

After Romania has ranked first for several months in the EU as regards the annual inflation rate, in August 2009, Hungary, which registered a rate of 5%, passed beyond Romania, with a 4.9% rate, while Poland ranked third with 4.3%. At the level of European Union, the Eurostat data for August 2009 showed that the inflation rate is at

0.6%, ascending from 0.2% in July 2009. In November 2009, Romania, with an inflation rate of 4.6% was behind Hungary, which recorded a rate of 5.2%, as EU's annual inflation rate was of 1% in November, and in the euro zone it reached 0.5% (EUROSTAT, 2009).

External support

Hungary's very low economic growth in 2008 is an indicator that the slowing down in the Eurozone has already been felt in this country and that the effects of the international financial crisis have a major impact upon it. Hungary's economic perspectives are not encouraging, since the country has had to impose severe fiscal and monetary targets, in order to be able to receive the IMF support package of 25 billion USD in October 2008. This package includes strict fiscal targets, which will prevent Hungarian authorities from increasing expenses so as to stimulate economic growth (here included reducing expenses, even freezing salaries). Thus, in October, the National Bank of Hungary increased the interest rate by 3 per cent points (to 11.5%), while Central Banks in the Czech Republic and Slovakia reduced it in the foregoing weeks, in accordance with the European Central Bank (Capitalul.ro, 17 November 2008). Moreover, the European Central Bank (ECB) announced that it will provide the Central Bank of Hungary with a loan up to 5 billion euro, while the latter is to present an extensive package of policies targeting the support of the internal financial markets (Romania Libera online, 16 October 2008).

Although even from 2008 the Romanian and foreign experts and financial analysts recommended **Romania** to reach for external help in order to diminish the effects of the crisis, the Romanian authorities did not consider help to be necessary at that time, claiming that the Romanian economy would not be affected too much by the crisis. Almost all along 2008, most of the voices were hoping that „their crisis will not hit us" (Dijmărescu, 2009:6). Subsequent events and data infirmed these excessively optimistic claims (with no solid reasons other than the elective one) and unrealistic at the same time, so as the authorities had to request external financial support. In March 2009, Romania contracted a two year stand-by agreement with the International Monetary Fund for 12.95 billion euro, the total package of external financing, from IMF, European Union, World Bank and EBRD, reaching 19.95 billion euro. The European Union contributes with 5 billion euro after a favorable response from the European Commission and European Council, the World Bank allows Romania to lend one billion euro, and the European Bank for Reconstruction and Development, alongside with other international financing institutions will give another billion euro. The program's objective is to soften the effects of the dramatic decrease of private capital flows towards Romania and to implement at the same time, the necessary economical politics measures to reduce fiscal misbalance and the consolidation of the financial system. The basic measures from the program are to strengthen fiscal politics, to reduce the Government's need of financing and to improve fiscal sustainability, therefore preparing Romania to possibly enter the euro zone (Mediafax News Agency, March 25, 2009).

Hence the international crisis has led in this area as well, of foreign help, to the leveling and reduction of the borders to the role of a simple administrative delimitation, which cannot stop the consequences of global effects upon one or the other of the two countries.

The evaluation of the rating agencies

International rating agencies consider the emergent countries to be most vulnerable to the international financial crisis due to high current account deficits and to important risk concerning short term external debt.

Table 3. Credit ratings – Central and Eastern Europe (*long-term foreign currency*)

Moody's		Standard & Poor's		Fitch	
Aaa		AAA		AAA	
Aa1		AA+		AA+	
Aa2	Slovenia	AA	Slovenia	AA	Slovenia
Aa3		AA-		AA-	
A1	Czech Republic, Estonia, Slovakia	A+		A+	The Czech Republic, Slovakia
A2	Poland, Lithuania	A	The Czech Republic, Estonia, Slovakia	A	
A3	**Hungary**, Latvia	A-	Poland	A-	Estonia, Lithuania, Poland
Baa1		BBB+	Lithuania	BBB+	
Baa2		**BBB**	Bulgaria, **Hungary**	**BBB**	**Hungary**, Latvia
Baa3	Bulgaria, **Romania**	BBB-	Latvia	BBB-	Bulgaria
Ba1		**BB+**	**Romania**	**BB+**	**Romania**
Ba2		BB		BB	
Ba3		BB-		BB-	
B1		B+		B+	

B2		B		B	
B3		B-		B-	

Source: Website CIB Bank from Portfolio.hu data collection

Standard & Poor's has lowered in October 2008 Romania's rating for long-term foreign currency sovereign credit from BBB- to BB+ with negative outlook, and to B from A-3 for short-term foreign currency sovereign credit, as a consequence of financing risks; this has dazzled the analysts, the Central Bank and the financial market. Although even the most pessimistic appraisals show a significant growth of its economy, Romania has the lowest rating in the European Union, lower than that of countries who have officially reached a crisis. The Governor of the National Bank of Romania has roughly criticized S&P's decision to downgrade Romania's rating, stating that the public debt of the country is at a low level (12% of GDP), contrary to the information looked into by the agency. The analysis made by the National Bank of Romania shows that Standard & Poor's decision is groundless, taking into consideration that other states in the region still have investment grade, despite the fact that certain macroeconomic indicators show a vulnerability at least as significant as Romania's, and the market's perception concerning Romania's country risk is rather different than that of the financial evaluation agency (Ziarul Financiar Website, October-November 2008; Romanian Agency for Foreign Investment, 11 November 2008).

Standard & Poor's lowered its credit rating on Hungary as well, to BBB from BBB+ with negative outlook, stating that „the ratings could be lowered further if the economic adjustment were to prove more disruptive than currently expected or if political support for fiscal consolidation were to falter". The Hungarian analysts, unlike the Romanian ones, weren't surprised by the decision taken by the rating agency, which was noticed due to a nearly entire lack of reaction on the market (the Standard & Poor's announcement has only determined a minimal depreciation of the forint compared to the euro). They feel that the agency's decision was to be expected, due to the fact that Hungary's economy is extremely vulnerable at the moment, and that their country is the focal point of the crisis in Central and Eastern Europe and the crisis was predictable. Therefore, they believe the state should have taken certain measures against the crisis a long time ago, and the bad economical policies between 2000 and 2006 (high inflation and interest rate, low and unstable economical growth, growing external debt) is a factor that has only worsen the crisis (CIB Bank Hungary, November 2008).

Fitch has also downgraded Romania and Hungary's ratings in November 2008, alongside of two emerging countries (Bulgaria and Kazakhstan), as they felt that they were exposed to large risks as a consequence of an increasing current account deficits and the dependence of external financing. Out of the four downgraded countries, Romania was most severely ratified, because its credit rating was cut by two notches to junk status. The country was downgraded to BB+ with negative outlook from BBB. The Fitch analysts motivate their decision with the concern induced by the economical politics of the country and its ability to avoid a financial and economic crisis. After reducing the country's rating, Fitch went on to downgrade the ratings of five different banks in Romania. The president of the Romanian Association of Banks, Radu Ghetea, claims that the downgrade of the banks is strictly connected to the downgrading of the country and not to the banks' performances which have a high stability. The Romanian Agency for Foreign Investments think that the decrease of Romania's rating by Fitch cannot be explained by the economical evolution and that the country will continue to be an attractive and profitable destination for investments, even though the rate of foreign investment growth will decrease, due to the world crisis. The financial analysts within the Association of The Financial and Banking Analysts of Romania also claim that the downgrading of Romania's rating wasn't an economically founded decision, although they admit that there have been economic politics mistakes (The Money Channel.ro; MoneyLine.ro; HotNews.ro, November 2008).

Hungary was given a less severe attendance, being downgraded one notch from BBB+ to BBB with stable outlook. In Hungary's case, the decision shows the seriousness of the recession in which the country abides at the moment and the correction of the economical imbalance. The help given to Hungary by IMF has eliminated the risks concerning external financing and liquidity, and therefore, Fitch assigned its ratings a stable perspective (The Money Channel.ro).

As for Romania's and Hungary's position in the classification of the countries in Central and Eastern Europe, the Romanian economical analysts think that placing Romania on the last position is groundless, considering that Hungary's economical situation is much worse. According to the euro parliamentarian Daniel Daianu – former Minister of Finances of Romania – Hungary's main advantage is the lower current account deficit, half of Romania's, and the rating's history which is far better than that of Romania (Bloombiz.ro, October 2008). Although the country's rating decrease might scare the investors, Romania still has the advantage of an expanding market.

Moody's is the only large rating agency which still gives Romania a grade with recommendation of investments, after Fitch and Standard & Poor's (S&P) have downgraded Romania during the fall of 2008 to a speculative level (junk).

Considering the mistakes made by the rating agencies in the past, it appears that their evaluations are not quite as significant as they used to be to the investors. This is due, on the one hand, to their loss of credibility, and on the other, to the evaluation that these investing companies will accomplish independently which therefore allows a fair analysis of the risks on the international markets. However, the ratings given by agencies, on long term will mark up the external financing, which might be seen in an abrupt decrease of the economical growth of the two countries in 2009.

In December 2009, Moody's has come up with a list of the most vulnerable states to the international crisis and amongst these were Romania and Hungary, alongside Bulgaria, Croatia, Korea, Kazakhstan, Turkey, Ukraine, South Africa, Baltic states and Pakistan. The agency's experts believe that the basic scenario for 2009-2010 shows that in general, the emerging economies will record a growth beneath their potential level (NewsIn News Agency, December 2008).

Foreign Direct Investment

Central and Eastern Europe attracts 28% of the projects and captures 58% of all jobs created. In 2007, investment projects into Central and Eastern Europe grew by 15%, despite a 7% fall in job creation (against 29% fewer jobs in Western Europe and 18% fewer across the continent). Most of the investments in Central and Eastern Europe are in the industry area (87%). The service sector recorded a decrease in 2007 compared to the year before, and the market part of the region in the area of service investments has remained reduced – 13% compared to 60% in Western Europe *(*Ernst & Young, *European Attractiveness Survey*, 2008:22).

Table 4. Top 10 countries for job creation in 2007

Rank in 2007	Country	Number of jobs created 2007	Market share 2007	Evolution 2006-2007
1	UK	24.186	13.7%	-13%
2	Poland	18.399	10.4%	-41%
3	Czech Republic	15.102	8.6%	-14%
4	Russia	14.934	8.5%	85%
5	France	14.488	8.2%	-29%
6	**Romania**	12.464	7.1%	-12%
7	**Hungary**	11.104	6.3%	-1%
8	Slovakia	8.479	4.8%	-37%
9	Spain	7.335	4.2%	-31%
10	Germany	5.972	3.4%	-40%

Source: *Ernst & Young Investment Monitor 2008*

In 2007, **Romania** was at the top in Central and Eastern Europe concerning the number of FDI projects, with a growing evolution since 2005 and in the top 10 European countries concerning the number of jobs created, tapping 7.1% of the jobs created in Europe (See Tables 4 and 5). The main investments are still in the industrial area, with 91% of the jobs having been created in this area. The worsening of the country's rating successively in October and November 2008 by two different international agencies (S&P and Fitch), have removed Romania from the group of the countries with investing rate, which offers unfavorable perspectives for the following years regarding attracting foreign investments. Many Romanian analysts feel that this downgrade will be reviewed shortly, being wrongly based and influenced by the international crisis and by a series of rushed actions concerning economic politics performed by the Romanian government (the announced salary growth). Therefore, Romania might still be an attractive destination for investments, although the international crisis will lead to the decrease of the foreign investment growth rate.

Hungary – after dominating the top of the countries in the region for a while, as a consequence of the measurements for fiscal consolidation, massive depreciation of the forint and more recently, of the powerful negative consequences of the financial crisis – was surpassed by Romania as well as by other central European countries due to the fact that many foreign investors sold their assets on the Hungarian market (See Table 5). Still, in 2007, it was in the top 10 countries of origin, on the 7th place as number of jobs created (but behind Romania). Concerning the number of projects, Hungary has drawn 25% more projects, notably manufacturing and logistics, climbing four positions on the scale compared to 2006, when it didn't even make it to top ten *(*Ernst & Young, *European Attractiveness Surve*, 2008:25-26). At the beginning of the 1990s, the market base privatization, a unique phenomenon in Central and Eastern Europe at the time, was the main stimulation for foreign investments in Hungary. FDI were crucial in the heightening of the country's economical performances and have built the motor behind Hungary's economic success for a good while. Hungary focused intensely on attracting advanced technologies and innovations in good production, which represents a higher added value. Investments in research and development, ICT, biotechnologies and logistics have become highly important. Not only have a high number of producers and service providers established in Hungary, but they have also brought within the country the main international suppliers, alongside with their subsidies. In 2006, there were over 30.000 companies with foreign capital in Hungary. Just like in all the other European states, the foreign investors from the UE-15 countries have been the main investors in Hungary (79%). Geographic proximity and historical relations explain the majority of European investors. Hungary's most important partner was Germany, participating with 30% of the total FDI, followed by the Netherlands (18%) and Austria (11%). The most significant non European investor was USA, with 5% of the total, and from the Asian countries, Japan and South Korea have had an expanding significance in FDI (*Hungarian Investment and Trade Development Agency,* 2006).

Table 5. Top 10 countries for number of projects in 2007

Rank in 2007	**Country**	**Number of projects 2007**	**Market share 2007**	**Evolution 2006-2007**
1	UK	713	19.2%	4%
2	France	541	14.6%	-4%
3	Germany	305	8.2%	7%
4	Spain	256	6.9%	21%
5	Belgium	175	4.7%	-5%
6	**Romania**	150	4.0%	7%
7	Poland	146	3.9%	-4%
8	Russia	139	3.7%	60%
9	**Hungary**	135	3.6%	25%
10	Switzerland	124	3.3%	-9%

Source: Ernst & Young Investment Monitor 2008

The study made by the company Ernst & Young, *2008 Southeast Europe Attractiveness Survey*, shows the fact that Southeast Europe is bridging the gap with Central Europe, because the attractiveness of this region for potential investors has grown by 4% in 2008 compared to 2007, whereas Central Europe's attractiveness has diminished by 2% over the same period of time. The top of the most attractive countries for investments of the region is led by Romania, followed by Turkey, Bulgaria and Greece. Romania also lies first in the top of the countries with the largest number of FDI projects, followed by Serbia and Bulgaria. On the psychological map drawn according to perception versus reality, Romania is also a detached leader, its strong points being labor costs, potential productivity increase and labor skills and its weaknesses, telecommunication infrastructures, transport and logistics infrastructures and social climate (Ernst & Young, *2008 Southeast Europe Attractiveness Survey*, 2008:8-23).

Over the past years, foreign investors have come to realize the fact that Romania is a powerful and mature consumer market. They have directed the investing trend towards mass consumption by developing projects mainly in the service area, but there are significant percentages in the financial and banking area, as well as communications (*Business Standard.ro*, 16 May 2008). The improvement of the business environment, the introduction of the unique rate of tax and a positive attitude of the foreign partners towards Romania have led to attracting a significant number of FDI between 2005 and 2008. In 2006, foreign direct investment has reached its highest level after 1990. The FDI record of 2006 is due to an extra amount of trust that Romania has earned through stability and predictability of the investing climate, competitive fiscal politics, low costs and qualified work and the nearing of Romania's joining of the European Union, which gave access to the unique European market to those who chose Romania for implementing their production abilities. In 2007, foreign direct investment in Romania has reached a level of 7 250 million euros, 31% representing foreign direct investors' equity stakes in the share capital of direct investment enterprises, 18% reinvested earnings and 51% the net credit received from direct foreign investors, including from within the group. The main areas where FDI has been accomplished are: manufacturing (32.9% of total), financial intermediation and insurance (23.3%), wholesale and retail trade (14%), construction and real estate (7.8%), telecommunications (6.5%) and services rendered to enterprises (4.5%). The main countries that have done FDI in Romania were: Austria (21.4%), the Netherlands (16.3%), Germany (11.7%), France (8.8%) and Greece (7.5%) (NBR, *Foreign Direct Investment in Romania as of 31 December 2007*). According to the Romanian Agency for Foreign Investment, „the total volume of foreign direct investments attracted in Romania reached Euro 7.194 billion in the first 9 months of 2008, representing a 40 % increase as against the same period 2007 and covering 56.6% of the January-September 2008 current account deficit (the rest of 47.3% is represented by intra-group credits)."(The Romanian Agency for Foreign Investment, 12 November 2008).

According to the study conducted by Emst&Young, *South Central Europe* A*ttractiveness Survey 2009,* the investors' loyalty towards this area remained constant during the past years, but there is a larger preoccupation amongst them for the quality of the business environment. The countries in South Central Europe have attracted 25% of FDI projects in CEE in 2004-2008, out of which 50% projects for manufacturing activity. The area has a leader (România, 49% from FDI), 3 followers (Bulgaria - 23%, Serbia – 13% and Croatia – 5%) and 6 emerging (Bosnia and Herzegovina, Macedonia, Moldova, Albania, Montenegro, Kosovo). The first investor in terms of job creation is Renault, with 3.657 jobs in the manufacturing sector, in Romania. In the top of most attractive countries in South Central Europe in 2009, Romania is on second placed, after Croatia, with a difference of just one percent (39% compared to 40% of the leader), being followed by Bulgaria (34%) and Serbia (33%). The major concerns of the investors regarding the business environment refer to threats such as corruption, political instability, salary increase, growth of real estate costs and skilled labour shortage. However, there is trust in the future from the investors, given by the four engines that can pull the entire region: Romania, Bulgaria, Croatia and Serbia (Ernst&Young, *South Central Europe* A*ttractiveness Survey 2009*).

According to the Ernst&Young study, *CEE* A*ttractiveness Survey 2009,* although Hungary is perceived as a quality location in the international competition, the country R&D potential is not recognized at its real value. As for the market quota as number of FDI attracted, Hungary ranked on the third place in 2008, with 10%, following Poland (18%) and Romania (15%). The crisis and competition in change have led to the change of market quota in 2004-2008, leading Hungary to go from second to third place and Romania to go from fourth to second place. The most important FDI accomplished by Hungary were in the following areas: automotive (45%), machinery and equipment (10%), retail (6%), furniture (6%), pharmaceutical (6%), business services (5%) and IT (4%). The top five quality assets for Hungary, as seen by the foreign investors, are: telecommunication infrastructure, local labour skills level, transport and logistics infrastructure, quality of education and quality of life. Meanwhile, the strategic weaknesses to be improved are: political stability, corporate taxation, labour costs, R&D quality, performance in innovation and labour law flexibility. The investors' confidence in the future attractiveness of Hungary is high and the measures recommended in order to improve Hungary's attractiveness are: to make tax and legal regulation more flexible, to ensure predictable environment, to promote economic growth and SME development, to promote entrepreneurship, to reform the social model and to renew the training and the education system (Ernst&Young, *CEE* A*ttractiveness Survey 2009*).

The international financial crisis is starting to be felt in the FDI area all over Europe. The potential investors will reanalyze their plans and investment decisions for the following years and some will certainly postpone their investments. The negative evaluations of the international rating institutions and lack of trust will influence the level of investments in the European Union and especially in its emerging countries, changing the market shares of these countries and generating changes in the FDI area structure.

Conclusions

Nowadays, the world economy is dominated by a widely used idiom: "the international economical crisis", which influences all the areas of a country's economy, its economic politics, its image and credibility in the eyes of foreign investors. For that matter, this crisis seems to be the only common ground between the two neighboring countries, Romania and Hungary. Despite being neighbors and having both only recently entered the European Union, the two states have different economic paths, marked by national economic politics, the strategies chosen by their governments and the way they are internationally perceived.

The new "tiger of the East" versus the "poorly prepared student" – a durable situation?

In November 2007, the French economic journal *Capital*, in an article dedicated to the newest EU member countries in Central and Eastern Europe, named Romania "the new tiger of the East", considering its economic growth one of the most outstanding in the region, and Hungary "the poorly prepared student of the class", following its modest indicators recorded by this country during the past years (*Capital*, November 2007:56-82). How durable, but even more so, how real is this situation?

Romania's "spectacular" economical growth was mainly based on consumption based on external financing and on private short term external loans, which will definitely be a problem in the following years, when the financial crisis will force the state to adopt politics of consumption limitation. On the contrary, Hungary is considered "the poorly prepared student" of the new UE members, due to the fact that it's been facing a low economic growth and high unemployment rate for several years now, which appears to be leading to a prolonged recession. Therefore, the country was forced to ask for external financial help, which has only enlarged its external debt, which was rather large either way. The inflation has also contributed to the reversal of the ratio between the two countries: if in 2000, Hungary had a far better situation compared to that of Romania (Hungary's inflation rate was only 9.8% as compared to Romania's 45.7%), the year 2008 finds the two states in a totally different situation, with similar inflation values. The inflation targets set by the Central Banks of the two countries for 2009 are 3.5% for Romania and 4.1% for Hungary. As far as the FDI goes, Romania has surpassed its neighbor, at least until 2008, both in the area of the country's attractiveness for foreign investors and as concerns the number of projects and jobs created. However, there is a significant difference of perception between the foreign investors and the view of the international rating agencies, which have placed Romania, more or less legitimately, at the bottom of the list of the Central and Eastern Europe, therefore behind Hungary.

We don't feel that the fact that, during a certain period, Romania having a better situation than Hungary is a long term trend, as worldwide economical instability and spectacular twists of classifications are a daily occurrence. Both governments have to understand that reaching and maintaining an ascending path requires, at this time, compelling measurements, even non populist and clear objectives for reaching and maintaining the economic indicators within the limits imposed by their desire to adhere to the Euro Zone.

It can be said, following this analysis, that the frontier doesn't induce similar evolutions of the two countries, which evolve according their own economical realities, but is subscribed to the general European frame. It can therefore be noticed that the specific forms of separation of the international trade – especially developmental, political and cultural separation – are still present (Head, 2007:7-21), even at the level of the European Union, through the different effects created in the economic evolution of the states.

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